COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0903H.03P
Bill No.: Perfected HS for HCS for HB 356
Subject: Taxation and Revenue - General; Taxation and Revenue - Income; Department of Revenue; Retirement Systems and Benefits - General
Type: Original
Date: March 23, 2023

Bill Summary: This proposal modifies provisions relating to income tax deductions for private pensions.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
General Revenue Fund*	Could exceed ($2,263,751)	(Could exceed $96,405,883)	(Could exceed $94,438,185)
Total Estimated Net Effect on General Revenue	**Could exceed ($2,263,751)**	**(Could exceed $96,405,883)**	**(Could exceed $94,438,185)**

*The fiscal note reflects the assumptions that the SB 3 (2022) reductions are triggered consecutively.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on <u>Other</u> State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Local Government	**$0 or (Unknown)**	**$0 or (Unknown)**	**$0 or (Unknown)**

FISCAL ANALYSIS

ASSUMPTION

Due to time constraints, **Oversight** was unable to receive some agency responses in a timely manner and performed limited analysis. Oversight has presented this fiscal note on the best current information that we have or on information regarding a similar bill(s). Upon the receipt of agency responses, Oversight will review to determine if an updated fiscal note should be prepared and seek the necessary approval to publish a new fiscal note.

Section 143.022 Business Income Exemption

Officials from the **Department of Revenue (DOR)** note this proposal attempts to add the income of farmers as reported on two specific IRS forms to the business exemption. Those forms are the Schedule F and Form 4835. It should be noted the income reported on Form 4835 is reported onto the Schedule E which is already exempt per statutes.

The Department used its internal Income Tax Model that contains confidential taxpayer data to calculate the fiscal impact. SB 3 adopted in 2022, lowered the individual income tax rate to 4.95% starting January 1, 2023, and additionally is projected to lower the current tax rate down to 4.5% over a period of years based on revenue growth. DOR will show the impact through the implementation period.

The Department notes that this income is reported at the time of filing of the return and will result in a loss to general revenue:

Tax Year (Fiscal Year)	Amount
2023 (FY 2024)	($2,160,600)
2024 (FY 2025)	($2,155,065)
2025 (FY 2026)	($2,102,909)
2026 (FY 2027)	($2,055,404)
2027 (FY 2028)	($2,014,848)

This proposal will require modification to the MO-A form and to the MO-1040 form. Additionally, DOR will need to modify their website and their individual income tax computer system. These changes are estimated to cost $7,193.

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes the DOR could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process.

Officials from the **Office of Administration - Budget and Planning (B&P)** note this proposal would add Schedule F (farm income) and Form 4835 to the list of income types included within the business income exemption. B&P notes that Form 4835 is for farm rental income, which is included within Schedule E and is therefore already included within the existing exemption. Therefore, this proposal will only add Schedule F to the business income exemption.

B&P further notes that the business income exemption was fully implemented for tax year 2023, with a total exemption allowance of 20%. In addition, this proposal will start on August 28, 2023. Therefore, B&P assumes that the exemption would apply to tax year 2023 income.

Using tax year 2020 data, the most recent and complete year available, and accounting for SB 3 (2022), B&P estimates that this provision may reduce TSR and GR by $2,263,751 in FY24. Once SB 3 (2022) has fully implemented, B&P estimates that this provision could reduce TSR and GR by $2,024,840 annually. Table 1 shows the estimated impact by year.

Table 1: Estimated Impact by Year

Tax Year	Fiscal Year	GR Loss
2023	2024	($2,263,751)
2024	2025	($2,163,156)
2025	2026	($2,158,848)
2026	2027	($2,111,498)
2027	2028	($2,067,217)
2028	2029	($2,024,840)

HA 1 - Section 143.114 Employee Stock Ownership Plan Deduction

Officials from the **Department of Revenue (DOR)** note this proposal extends the Employee Stock Ownership Plan Deduction. This deduction was to sunset on December 31, 2022, and the sunset language is removed thereby assuring this deduction will be permanent. Extending or removing the sunset language of an existing program is not expected to have impact.

For informational purposes, this deduction began in 2017. No one claimed the credit in 2017. In 2018, 17 people claimed the credit. However, in 2019 & 2020 more than zero but less than the minimum reportable number filed for this deduction. Under Section 32.057, the Department does not disclose the number of tax returns or amounts claimed if the number is so low it could identify the taxpayer. The minimum number of returns to report is 10. What DOR can provide is the grand total claimed from 2017-2020 which was $722,342.

Oversight is unable to estimate the amount to be claimed under this deduction in future years. However, using DOR's total of $722,342 in deductions claimed from 2017-2020 (4 years), we could estimate the average annual impact over that time period was $9,751 ($722,342 / 4 years x

5.4% individual income tax rate). Therefore, Oversight will show a negative unknown impact for this provision, not reaching the $250,000 threshold.

Officials from the **Office of Administration - Budget and Planning (B&P)** note this program extends the current income tax deduction for capital gains related to certain employee stock ownership sales. B&P notes that this is an extension of an existing program. Therefore, this provision will not impact TSR or the calculation under Article X, Section 18(e).

Section 143.124 Pension Income Subtraction

Officials from the **Department of Revenue (DOR)** note this proposal is changing the taxability of retirement income. Currently, depending on the type of retirement benefit and the taxpayer's Missouri adjusted gross income (MAGI) some of the benefits are taxable.

Public Retirement Benefits
Per statutes, any retirement benefits other than public pension benefits are eligible to receive up to the first $6,000 in income from retirement benefits as an exemption from taxation. This would include pensions from private companies, 401(k), deferred compensation plans, annuities, and self-employed retirement plans (Keogh). This exemption is only allowed for individual taxpayers with a MAGI of less than $25,000 or for those filing a combined return of up to $32,000 MAGI.

Starting January 1, 2024, this proposal would increase the $6,000 to $12,000 for taxpayers. It would also increase the number of people eligible for this exemption by increasing the MAGI of individual filers to $50,000 and the MAGI of combined filers to $64,000. This will increase the number of people eligible for this exemption.

Impact
The Department notes these changes are to begin for tax years starting January 1, 2024 and therefore will not fiscally impact the state until FY 2025 based on when the tax returns are filed claiming the exemption.

We used information reported by taxpayers on their federal returns to start the calculation of the additional revenue that may be exempt from tax. Then DOR used their internal Individual Income Tax Database for Missouri DOR found the following distribution of filers of public and private pensions.

Pensions	Public	Private
Singles	39%	61%
Married Filing Joint	49%	51%
Head of Household (HOH)	42%	58%

Here is the estimated loss per benefit type:

Estimated Loss by Retirement Income

Retirement Income	4.95%	4.80%	4.70%	4.60%	4.50%
Individual Retirement Distributions	($37,803,249)	($36,657,696)	($35,893,994)	($35,130,292)	($34,366,590)

Pensions/Annuities (Private)	($58,933,237)	($57,147,381)	($55,956,811)	($54,766,240)	($53,575,670)
Self-Employed (Keogh)	($451,327)	($437,650)	($428,532)	($419,415)	($410,297)
Total GR Loss	**($97,187,813)**	**($94,242,727)**	**($92,279,337)**	**($90,315,947)**	**($88,352,557)**

SB 3 adopted in 2022 set the individual income tax rate at 4.95% in tax year 2023. The tax rate is scheduled to continue to reduce over a period of several years until the rate equals 4.5%. At that time it will remain the 4.5%. Since this proposal begins with tax year 2024 (FY 2025) the rate is estimated to be 4.8%. For fiscal note purposes, DOR will show the loss at each of those tax rates over SB 3's implementation period. This will result in a loss to general revenue. DOR estimates the loss to general revenue:

Estimated Loss by Fiscal Year

	Tax Year (Fiscal Year)			
Tax Rate	2024 (FY25)	2025 (FY26)	2026 (FY27)	2027 (FY28)
4.95%	($97,187,813)	($97,187,813)	($97,187,813)	($97,187,813)
4.80%	($94,242,727)	($94,242,727)	($94,242,727)	($94,242,727)
4.70%		($92,279,337)	($92,279,337)	($92,279,337)
4.60%			($90,315,947)	($90,315,947)
4.50%				($88,352,557)

Administrative Impact

This proposal will require modification to the MO-A form and to the MO-1040P form. Additionally DOR will need to modify their website and their individual income tax computer system. These changes are estimated to cost $7,193.

At this time the Department believes it can handle this work with existing resources. However, should DOR reach the number of errors or correspondence to justify additional FTE from this proposal or in combination with other proposals that will pass, DOR will seek the required number of FTE through the appropriation process. The Department is providing the number of errors or correspondence that require additional FTE.

1 FTE Associate Customer Service Rep for every 14,700 errors created
1 FTE Associate Customer Service Rep for every 5,700 pieces of correspondence generated

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes the DOR could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process.

Officials from the **Office of Administration - Budget and Planning (B&P)** note:

Individual Retirement Distributions

Currently taxpayers may subtract $6,000 of their individual retirement income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers. B&P notes that these payments would include IRAs and 401(k) plans.

This proposal would allow taxpayers to subtract $12,000 of their retirement income, if their MAGI is less than $50,000 for singles and $64,000 for married filing combined taxpayers.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $356,706,746 in individual retirement arrangement payments for taxpayers filing single, $119,123,284 for taxpayers filing head of household, and $366,736,152 for married filing joint taxpayers; for a total of up to $763,701,991 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $37,803,249 (top tax rate 4.95%) or by $36,657,696 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $34,366,590 annually.

<u>Pensions and Annuities</u>
B&P notes that the term "pensions and annuities" includes both public and private retirement funds. For the purpose of this fiscal note, B&P used tax year 2020 (the most recent complete year available) Missouri tax return data to estimate the percentage of payments from public pensions and annuities versus private pensions and annuities.

In tax year 2020, 61% of pension and annuity payments were from private funds and 39% were from public funds for individuals filing single. For married filing combined individuals, 51% of payments were from private funds, while 49% were from public funds. For taxpayers filing as head of household, 58% of pension and annuity payments were from private sources, while 42% were from public sources.

<u>Private Pensions and Annuities</u>
Currently taxpayers may exempt $6,000 of their private pension and annuity income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers.

This proposal would allow taxpayers to subtract $12,000 of their retirement income, if their MAGI is less than $50,000 for singles and $64,000 for married filing combined taxpayers.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $749,989,260 in private pension and annuity payments for taxpayers filing single, $231,810,834 for taxpayers filing head of household, and $509,493,355 for married filing joint taxpayers; for a total of up to $231,810,834 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $58,933,237 (top tax rate 4.95%) or by $57,147,381 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $53,575,670 annually.

Self-Employed (Keogh) Payments
Currently taxpayers may exempt $6,000 of their Keogh retirement income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers.

This proposal would allow taxpayers to subtract $12,000 of their retirement income, if their MAGI is less than $50,000 for singles and $64,000 for married filing combined taxpayers.

Based on data published by the IRS, B&P estimates that this provision may exempt $3,566,765 in Keogh payments for taxpayers filing single, $1,160,709 for taxpayers filing head of household, and $5,160,139 for married filing joint taxpayers; for a total of $1,160,709 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $451,327 (top tax rate 4.95%) or by $437,650 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $410,297 annually.

Pension Subtraction Summary
B&P estimates that this proposal could reduce TSR and GR by $97,187,813 (top tax rate 4.95%) or by $94,242,727 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this proposal could reduce TSR and GR by $88,352,557 annually. Table 1 shows the estimated loss by provision, while Table 2 shows the estimated loss by tax and fiscal year.

Table 1: Estimated Loss by Retirement Income

Retirement Income	4.95%	4.8%	4.7%	4.6%	4.5%
Individual Retirement Distributions	($37,803,249)	($36,657,696)	($35,893,994)	($35,130,292)	($34,366,590)
Pensions/Annuities (Private)	($58,933,237)	($57,147,381)	($55,956,811)	($54,766,240)	($53,575,670)
Self-Employed (Keogh)	($451,327)	($437,650)	($428,532)	($419,415)	($410,297)
Total GR Loss	**($97,187,813)**	**($94,242,727)**	**($92,279,337)**	**($90,315,947)**	**($88,352,557)**

Table 2: Estimated Loss by Fiscal Year

	Tax Year (Fiscal Year)			
Tax Rate	2024 (FY25)	2025 (FY26)	2026 (FY27)	2027 (FY28)
4.95%	($97,187,813)	($97,187,813)	($97,187,813)	($97,187,813)
4.80%	($94,242,727)	($94,242,727)	($94,242,727)	($94,242,727)
4.70%		($92,279,337)	($92,279,337)	($92,279,337)
4.60%			($90,315,947)	($90,315,947)
4.50%				($88,352,557)

Oversight notes both DOR and B&P's estimates include data from DOR and B&P's internal Income Tax Model.

Oversight notes that it does not currently have the resources and/or access to state tax data to produce a thorough independent revenue estimate and is unable to verify the revenue estimates provided by B&P and DOR. Therefore, for the purpose of this fiscal note, Oversight will note DOR's and B&P's estimated impact for this provision. For the purpose of this fiscal note, Oversight will reflect the assumption that the SB 3 (2022) reductions are triggered consecutively.

HA 2 - Section 273.050 Dog Tax (Repealed)

Officials from the Office of Administration - Budget and Planning (B&P) note this proposal would remove the annual payment due date and allow dogs to remain in Missouri if the local option dog tax (Section 273.060) is not paid. However, this proposal does not remove the actual local tax levy, only the statute containing the due date. Therefore, it would be possible for a local jurisdiction to still levy the tax and set their own annual due date. B&P notes that such local tax is not currently levied in any county in Missouri. This provision will not impact TSR or the calculation under Article X, Section 18(e).

Oversight only reflects the responses received from state agencies and political subdivisions; however, other county officials were requested to respond to this proposed legislation but did not. A listing of political subdivisions included in the Missouri Legislative Information System (MOLIS) database is available upon request.

Officials from the **Joint Committee on Administrative Rules** assume this proposal is not anticipated to cause a fiscal impact beyond its current appropriation.

FISCAL IMPACT – State Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
GENERAL REVENUE FUND			
Revenue Reduction - §143.022 – Business Exemption p. (3-4)	($2,263,751)	($2,163,156)	($2,158,848)
Revenue Loss – §143.114 Employee Stock Ownership Deduction – extends sunset date p. (4)	(Unknown)	(Unknown)	(Unknown)
Revenue Reduction - §143.124 – Retirement Income Tax Deduction p. (5-9)	$0	($94,242,727)	($92,279,337)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**Could exceed ($2,263,751)**	**(Could exceed $96,405,883)**	**(Could exceed $94,438,185)**

FISCAL IMPACT – Local Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
LOCAL POLITICAL SUBDIVISIONS			
Revenue Reduction - §273.050 – Repeal of tax on dogs	$0 or (Unknown)	$0 or (Unknown)	$0 or (Unknown)
ESTIMATED NET EFFECT ON LOCAL POLITICAL SUBDIVISIONS	**$0 or (Unknown)**	**$0 or (Unknown)**	**$0 or (Unknown)**

FISCAL IMPACT – Small Business

Section 143.022 - This provision would positively impact small businesses that qualify for the exemption as described in the proposal.

Section 143.114 - This provision would positively impact small businesses that sell or exchange qualified employer securities.

FISCAL DESCRIPTION

This legislation modifies provisions relating to income tax deductions for private pensions

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Revenue
Office of Administration - Budget and Planning

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